

Message Text

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ACTION EA-12

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UNCLAS HONG KONG 10796

STATE PASS TREASURY AND FEDERAL RESERVE

E.O. 11652: N/A
TAGS: BFIN, HK
SUBJECT: RECENT HONG KONG BANKING DEVELOPMENTS

REF: HONG KONG 6972 AND PREVIOUS

1. NEW LICENSES. ISSUANCE OF SEVEN ADDITIONAL BANKING
LICENSES HAS BEEN ANNOUNCED BY THE HKG BRINGING THE TOTAL
TO 16 SINCE THE RELAXATION LAST MARCH OF THE LONG-STANDING
MORATORIUM ON NEW BANK LICENSES. THE SEVEN RECIPIENT BANKS:
BANK OF MONTREAL, BANQUE DE PARIS AND DES PAY-BAS, CANADIAN
IMPERIAL BANK OF COMMERCE, COMMERZBANK, CREDIT LYONNAIS,
SOCIETA GENERALE (OF FRANCE) AND THE STATE BANK OF INDIA.
OF THE NINE NEW LICENSES PREVIOUSLY ISSUED (IN MAY) THERE WERE
THREE AMERICAN BANKS: CHEMICAL BANK, MANUFACTURERS HANOVER
AND MORGAN GUARANTY (SEE HONG KONG 6972).

2. OFFSHORE PROFITS TAX. POLEMICS OVER THE INLAND REVENUE
(AMENDMENT) BILL 1978 STARTED ANEW WITH THE RETURN OF
FINANCIAL SECRETARY PHILIP HADDON-CAVE FROM A 5-6 WEEK VACATION.
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THE BILL CALLS FOR EXTENDING THE HONG KONG 17 PERCENT PROFITS
TAX TO INTEREST EARNED BY FINANCIAL INSTITUTIONS ON OFFSHORE
LOAN TRANSACTIONS ARRANGED IN HONG KONG WITHOUT THE "SUBSTANTIAL
INTERVENTION" OF A BRANCH OUTSIDE HONG KONG. BANKS, CHAMBERS
OF COMMERCE AND OTHERS IN AND OUTSIDE HONG KONG HAVE BEEN
CHALLENGING THE BILL FOR ITS AMBIGUITIES AND OTHER FEATURES
SINCE ITS INTRODUCTION LAST MARCH, WITH THE RESULT THAT DEBATE

ON IT IN THE LEGISLATIVE COUNCIL HAS BEEN POSTPONED SEVERAL TIMES. THE RELATED UNCERTAINTIES HAVE ALSO CAUSED A NUMBER OF OFFSHORE LENDING INSTITUTIONS TO FORMULATE AND IN SOME CASES IMPLEMENT CONTINGENCY PLANS FOR MOVING THEIR OFFSHORE TRANSACTIONS ELSEWHERE. ONE MAJOR AMERICAN BANK HAS ALREADY ANNOUNCED THAT IT IS BOOKING MOST OF ITS NEW OFFSHORE LOANS IN BAHRAIN AND THAT IT WILL PROBABLY MOVE A GOOD PART OF ITS EXISTING PORTFOLIO THERE AFTER DUE NOTIFICATION TO BORROWERS AND SYNDICATE PARTICIPANTS. (NOTE: THE FINANCIAL SECRETARY SOME MONTHS AGO SAID SUCH SHIFTING WOULD NOT ESCAPE THE PROPOSED TAX OF IN FACT THE LOANS WERE ARRANGED IN HONG KONG).

3. THE CURRENT FLURRY STARTED EARLIER THIS MONTH WHEN THE FINANCIAL SECRETARY MADE A PUBLIC SPEECH STRONGLY DEFENDING THE BILL WITH SUCH POINTS AS (A) THE INEQUITY OF PERMITTING ONE INDUSTRY (BANKING) TO ESCAPE THE PROFITS TAX WHILE OTHERS (EXPORT MANUFACTURING INDUSTRIES) MUST PAY IT, (B) HIS MYSTIFICATION AT THOSE WHO SEE THE BILL AS A MAJOR DEPARTURE FROM A FISCAL SYSTEM HISTORICALLY DESIGNED TO ENCOURAGE BUSINESS ENTERPRISE AND (C) THE ESSENTIALITY OF TAXING ALL HONG KONG-ORIGIN PROFITS IF HONG KONG'S LOW AND NARROWLY BASED TAX SYSTEM IS TO BE PRESERVED. MORE RECENTLY AN AD HOC GROUP IN THE LEGISLATIVE COUNCIL PUBLICIZED A SERIES OF PROPOSED AMENDMENTS IT BELIEVED ESSENTIAL, A FEW OF WHICH IT SAID HAD ALREADY RECEIVED THE FINANCIAL SECRETARY'S CONCURRENCE E.G. AN AMENDMENT THAT WOULD ACCORD SOME RELIEF FROM DOUBLE TAXATION, ANOTHER TO LIMIT CERTAIN (BUT NOT ALL) RETROACTIVE

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EFFECTS ANOTHER REMOVING THE WORDS "DIRECTLY OR INDIRECTLY" WITH RESPECT TO INTEREST EARNINGS SUBJECT TO THE TAX (THIS TO REDUCE POSSIBILITIES OF FUTURE INTERPRETATIONS BROADER THAN CURRENTLY INTENDED) AND ONE DEFINING FINANCIAL INSTITUTIONS MORE PRECISELY (TO EXCLUDE TRADING COMPANY FINANCIAL TRANSACTIONS). DISCUSSIONS ON ADDITIONAL AMENDMENTS AND CHANGES DESIRED BY THE AD HOC GROUP AND OTHERS WILL PROBABLY CONTINUE AT LEAST UNTIL AUGUST 16 WHEN BILL IS DUE FOR ANOTHER READING IN THE LEGISLATIVE COUNCIL. CURRENT OUTLOOK IS FOR PASSAGE OF THE BILL (WITH FOREGOING AND PERHAPS OTHER LAST-MINUTE AMENDMENTS), SINCE VETOES BY THE LEGISLATIVE COUNCIL ARE RELATIVELY RARE IN HONG KONG. ALSO HOWEVER UNHAPPY THE AD HOC GROUP MAY BE WITH ITS SPECIFICS, IT IS ON RECORD AS BROADLY AGREEING WITH THE PURPOSE OF THE BILL NON DISCRIMINATORY TAXATION. (SEE HONG KONG 6972 AND 4700).

4. HONG KONG SHANGHAI BANK AND MARINE MIDLAND NEW YORK. HONG KONG SHANGHAI BANK ANNOUNCED THE SIGNING OF A LETTER OF INTENT WITH CENTRAL BANK OF OAKLAND CALIFORNIA FOR PURCHASE BY LATTER OF ITS SUBSIDIARY HK BANK OF CALIFORNIA. CONDITIONS INCLUDE APPROVAL BY US BANK REGULATORY AUTHORITIES

AND SUCCESSFUL CONCUSION OF A MAJORITY CONTROL ACQUISITION
OF MARINE MIDLAND BY HONG KONG SHANGHAI BANKING CORPORATION.
LETTER DOES NOT COVER LATTER'S AGENCY OFFICES IN SAN FRANCISCO
AND LOS ANGELES OR ITS GUAM OPERATION. (SEE HONG KONG 5224 AND
RELATED MEMCON SENT STATE-PRC.)

5. BANK INTEREST RATES INCREASED. IN A MOVE TO TONE UP
THE HONG KONG DOLLAR, COMMERCIAL BANKS LED BY THE HONG KONG
SHANGHAI BANK AND THE CHARTERED BANK INCREASED BOTH THEIR PRIME
LENDING AND DEPOSIT INTEREST RATES IN JULY. PRIME LENDING
RATE WENT TO 6 PERCENT (UP FROM 5 AND ONE-HALF PERCENT) WHILE
DEPOSIT RATES WERE RAISED TO 2 AND ONE-HALF DEMAND AND THREE
MONTHS, 3 AND ONE-FOURTH PERCENT SIX-MONTHS AND 4 AND THREE-FOURTHS
PERCENT ONE YEAR. NEW PRIME RATE COMPARES WITH 5 AND ONE-HALF
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PERCENT SINCE MAY 1978, 4 AND THREE-FOURTHS DURING 1977 AND
EARLY 1978, 6 PERCENT IN 1976, 6 AND ONE-HALF PERCENT
IN 1975 AND A PEAK OF 12 PERCENT IN 1974. (SEE
HONG KONG 5367).
SHOESMITH

NOTE BY OC/T: MESSAGE DELAYED IN TRANSMISSION.

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